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No. 99-120

IN THE

Supreme Court of the United States

TUSCHNER & COMPANY, INC. and
JOHN M. TUSCHNER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITIONERS' REPLY BRIEF

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The assertion of the Securities and Exchange Commission ("Commission" or "SEC") that the district court has subject matter jurisdiction of the SEC's claim – *i.e.*, a claim that the broker-dealer regulatory provisions of the federal securities laws require the principal of a foreign securities broker, who does business on behalf of his foreign customers with a United States broker, to register and be subject to SEC regulation as an "associated person" of that United States broker – depends upon the validity of four SEC contentions:

(i) a test developed by the lower courts to determine the scope of the *antifraud provisions* should also be used to ascertain the reach of the *broker-dealer regulatory provisions* here in issue, see Opp. at 7-10;

(ii) in applying the test, the courts should ignore Section 30(b) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] the only provision of the Exchange Act in which Congress addressed the cross-border reach of that statute, Opp. at 11-12;

(iii) the plain words of SEC Rule 15a-6[2] do not mean what they say and the fact that the SEC affirmatively decided *not* to preclude barred persons from relying on the exemption provided by subsection (a)(4)(i) of the Rule should also be disregarded, Opp. at 12-13; and

(iv) the statutory term "associated person" should be given an entirely unworkable definition which no court or prior administrative decision has endorsed, Opp. at 13-16.

For the reasons stated in the Petition and herein, these contentions are in error. The petitioners[3] respectfully request that a writ of certiorari issue to address the Eighth Circuit's departure from established precedent regarding the extraterritorial application of the federal securities laws.

1. Other than the courts below, courts have not applied either the "conduct" test or the "effects" test, judicially-created rules developed to determine the extraterritorial scope of the antifraud provisions of the securities laws, to the regulatory provisions pertaining, *inter alia*, to the registration

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[1] Congress specified in Section 30(b) that no provision of the Exchange Act shall apply to a foreign "business in securities," unless otherwise provided in SEC rules. 15 U.S.C. § 78dd(b).

[2] Under Rule 15a-6, a foreign broker may, on behalf of his customers, "effect transactions in securities with . . . a registered broker or dealer," without triggering the broker-dealer registration provisions of the securities law. 17 C.F.R. § 240.15a-6(a)(4)(i).

[3] Since the filing of the Petition, John Tuschner has resigned from his positions at Tuschner & Co. The company no longer conducts broker-dealer operations and, on September 1, 1999, it filed an application with the SEC to withdraw its broker-dealer registration. These developments do not moot the issues raised in the Petition, as the SEC continues to seek all the relief requested in its Complaint.

of persons, entities or securities. To the contrary, courts have concluded that "the antifraud provisions of American securities laws have broader extraterritorial reach than American filing requirements." *Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252, 262 *as amended*, 890 F.2d 569 (2d Cir. 1989).[4] Here, in both relaxing the requirements of the "conduct" test and applying the liberalized test to regulatory provisions pertaining to the definition and registration of "associated persons," the lower courts came to the opposite conclusion, conferring even greater scope on an "American filing requirement" than has previously been afforded the antifraud provisions. This holding represents a departure from the established extraterritorial jurisprudence of other federal courts, which has created a substantial conflict.

The SEC offers one reason why the prior cases determining the extraterritorial scope of the antifraud provisions apply here: in this case, the SEC points out, it is seeking to "enforce" its 1993 regulatory bar order against Zahareas. Opp. at 9-10. This puts the cart before the horse. As the SEC concedes (Opp. 10), its 1993 order barred Zahareas solely from "the *United States* securities business;" since Zahareas never sought to re-enter the *United States* securities industry, there is no basis upon which the SEC could seek to "enforce" the bar order.[5] Moreover, the SEC's observation (Opp. 10) that "Congress did not want" the United States to become a "base for fraudulent activity" is singularly inappropriate. The SEC *found* no fraud during its extensive investigation, it *alleged* no fraud in its Complaint,

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[4] *See also, Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 124 (2d Cir. 1998), *cert. denied*, 119 S.Ct. 1029 (1999); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 986 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975). *Plessey Co. PLC v. General Electric Co. PLC*, 628 F. Supp. 477 (D. Del. 1986).

[5] *Cf., Teicher v. SEC*, 177 F.3d 1016 (D.C. Cir. 1999) (SEC bar order was in excess of SEC's powers, to the extent it purported to bar broker from other securities-related professions).

and, in any event, all the significant conduct in this case involving customer contact (the only conduct which *could* have involved fraud) occurred *entirely* in Greece.

In contrast to its position here, the SEC aptly noted in its *amicus* brief in the Second Circuit in *Consolidated Gold Fields PLC v. Minorco, S.A.*, *supra*, that it is "well-settled" that the antifraud provisions of the federal securities laws apply more broadly than "registration requirements." SEC Brief (Dec. 1988) at 16. The SEC explained, *id.* at 17:

> This is because antifraud provisions are designed to enforce fundamental notions of honesty. Moreover, fraud is universally proscribed, while registration and filing requirements may vary considerably in different countries, and compliance with the antifraud provisions generally imposes less of a burden on foreign companies than does compliance with regulatory requirements.[6]

The SEC was correct in its 1988 Brief, and correct in 1989 when it enacted Rule 15a-6. The position it takes here is wrong.

2. With respect to the Section 30(b) and Rule 15a-6 issues, the SEC itself alleges both that Zahareas conducted a "business in securities" in Greece[7] and that, acting

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[6] In so stating, the SEC relied upon the Restatement (Third) of the Foreign Relations Law of the United States, Section 416, Comment a (titled "Jurisdiction to Regulate Activities Related to Securities") which states that "an interest in punishing fraudulent or manipulative conduct is entitled to greater weight than are routine administrative requirements," such as an "obligation to file . . . not directly associated with fraud." *Id.* at 297 and Reporters' Note 2 at 300. *See* SEC Brief in *Consolidated Gold Fields* at 17.

[7] 15 U.S.C. § 78dd(b). In its Complaint, a copy of which is being lodged with this Court, the SEC alleged, *id.* at ¶ 14: Euroamerican is a "Greek brokerage firm, based in Athens, Greece." Since Euroamerican is a foreign "broker" for purposes of the securities laws, Zahareas necessarily is also, since a "broker" is any "person" (defined in Section 3(a)(9) of the Exchange Act to include both individuals and entities, 15

Footnote continued on next page . . .

independently of Tuschner Co., he "effect[ed] transactions in securities with ... a registered broker or dealer."[8] Nevertheless, the SEC advances the circular argument that Zahareas cannot be a "foreign broker" because he is, in fact, an "associated person" of Tuschner & Co. But the *reasons* offered as to *why* he is an "associated person" of Tuschner & Co. all come down to one thing: he participated in transactions that are specifically included in Rule 15a-6 as transactions which do not bring a foreign broker within the SEC's regulatory ambit.[9]

Footnote continued from previous page . .

U.S.C. § 78c(a)(9)) "engaged in the business" of effecting securities transactions as an agent. 15 U.S.C. § 78c(a)(4).

[8] 17 C.F.R. § 240.15a-6(a)(4)(i). See Complaint, ¶¶ 21-22: "Zahareas ... directed and controlled Euroamerican's ... transactions with Tuschner & Co.," whereby "the Greek accounts purchased and sold approximately $9 million worth of securities through Tuschner & Co." As the dissent in the Eighth Circuit pointed out, the facts alleged by the SEC showed that Tuschner & Co. and Euroamerican were simply "two separate companies doing business with each other," with neither "under the control of the other." Pet. App. 5a.

[9] The SEC contends that Section 30(b) applies only where the activities in issue, "while involving some contacts with the United States, were in all significant respects foreign." Opp. at 11. With respect to Zahareas' and Euroamerican's *broker-dealer* activities, the activities addressed by the *broker-dealer regulatory provisions* here in issue, that is of course precisely the case here. The SEC's purported distinction (Opp. at 12-13) between broker-dealer "registration" requirements and broker-dealer "regulation," and its contention that a foreign broker may be exempt from the less onerous "registration" requirements but not from the considerably more burdensome aspects of SEC "regulation," is inconsistent with the statutory scheme established by the Exchange Act. Under that scheme, registration is the gateway to regulation. If a broker is not required to register, it will not even be included in the SEC's census of regulated entities, and the SEC will have no viable means of monitoring its securities practices and financial condition, as the Exchange Act requires the SEC to do. The SEC does not explain the basis upon which it has purportedly elected to ignore, as to *some* brokers, a Congressional directive that *all* brokers subject to the Act register with the SEC. *See* 15 U.S.C. § 78o(a).

The SEC briefly suggests (Opp. at 10) that this Court should not grant certiorari because, in rejecting the petitioners' contention that subject matter jurisdiction of the SEC's claims was lacking, the lower courts did not "expressly" discuss Section 30(b) or Rule 15a-6. The SEC's own appellate brief, lodged with this Court by the SEC, illustrates that the Section 30(b) and Rule 15a-6 arguments made here were extensively argued below.[10] To the extent the SEC's observation is intended to suggest that the jurisdictional issues might be clarified by further proceedings below, that suggestion is directly contrary to the position taken by the SEC below. There, after its victory in the Eighth Circuit, the SEC immediately moved to strike all of the petitioners' affirmative defenses, including the defenses based on Section 30(b), Rule 15a-6 and lack of subject matter jurisdiction, and to preclude any discovery regarding the factual circumstances of other applications of Section 30(b) and Rule 15a-6. The district court recently granted both motions.[11] Thus, under the present law of the case, there will, as requested by the SEC below, be no further discovery, fact-finding or judicial consideration below of the subject matter jurisdiction issues.

Finally, the SEC has no response to the point made in the Petition (p. 21, n.24), that if the SEC believes that a barred individual who becomes a broker in a foreign nation just should not be allowed to engage in the transactions covered by Rule 15a-6(a)(4), it should have simply said so in the Rule

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[10] *See* SEC Br. at 23-29, setting forth the SEC's counter-argument that neither Section 30(b) nor Rule 15a-6 "divested" the district court of subject matter jurisdiction.

[11] Magistrate Judge's Report and Recommendation (striking the defendants' affirmative defenses), August 23, 1999; Magistrate Judge's Order (denying Tuschner & Co.'s motion to compel SEC to designate a deposition witness knowledgeable as to, *inter alia*, the prior application of Rule 15a-6), August 23, 1999. The petitioners have moved the district court to reconsider both rulings; the motion is pending.

itself.[12] That is, after all, what the SEC did with respect to the foreign broker transactions covered by Rule 15a-6(a)(3) – *i.e.*, transactions effected with U.S. institutional investors through U.S. brokers. The fact that the very next subparagraph, Rule 15a-6(a)(4), contains no such limitation as to barred individuals can only be interpreted as an affirmative decision by the SEC, at the time it enacted the Rule, that such a preclusion was, if not impermissible under Section 30(b), at least neither necessary nor appropriate to protect U.S. investors or the U.S. securities markets.

3. The SEC contends (Opp. at 13) that its claim that Zahareas is an "associated person" of Tuschner & Co. is "fact-bound." But, at least for present purposes, the facts to which all parties are bound are the same facts upon which the lower courts decided the matter – the well-pleaded facts alleged by the SEC, taken as true.[13] While the SEC has, after the subject matter jurisdictional issue was raised, attempted to embroider and add pejorative coloration to its allegations, the Complaint has never been amended, all the embroidery has added nothing of substance, and the relevant facts remain as initially alleged by the SEC.

As to the merits of the issue, the SEC does not contend that status as a barred individual is a factor that has any bearing on the question whether one is an "associated person" of a particular firm; indeed, Section 3(a)(18) makes it clear that only a person's activities in relation to that firm can provide the basis for such a conclusion. But the SEC has never answered the question: why do Zahareas' activities to obtain U.S. securities for his Greek customers through the

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[12] Moreover, in Section 30(b), Congress granted the SEC open-ended authority to prescribe rules to "prevent the evasion of" the Exchange Act by a foreign "business in securities." 15 U.S.C. § 78dd(b). This rule-making power has never been exercised by the SEC.

[13] The district court conducted no evidentiary proceedings before holding that the SEC was sufficiently likely to succeed upon its factual and legal claims to warrant injunctive relief. Pet. App. 19a-20a.

only available source, a U.S. broker-dealer, make him an "associated person," when the similar activities of other foreign brokers have never been held by the SEC to do so? *See, e.g., Bear Stearns & Co.*, International Series Rel. No. 85, 43 SEC Docket (CCH) 608 (Jan. 7, 1976).[14]

The SEC offers one rather remarkable basis to distinguish its *Bear Stearns* precedent from the facts of this case. The SEC suggests that the facts underlying *Bear Stearns* do not exactly mirror those of this case because the foreign broker that did business with Bear Stearns had "substantial business apart from its relation with the American firm." The SEC contends that there is "no record evidence" that the Greek customers "had any relationship with Euroamerican apart from" their transactions done through Tuschner & Co. Opp. at 15. But the fact that these accounts came to Tuschner & Co. solely through the efforts of Euroamerican is certainly substantial evidence of a prior, independent relationship between the customers and

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[14] In enacting Rule 15a-6, the SEC stated that it intended to "codify" its prior rulings regarding foreign broker activities, and it specifically referred to *Bear Stearns* as one such ruling. *See* Release 27017, 54 Fed. Reg. 30030, n.203, and 30019, n.58, citing several similar rulings.

In addition to the examples provided in Release 27017, recent news reports have detailed the ongoing expansion of such foreign broker activities. *See, e.g.*, "Do It Yourself: Online Brokerage Firms Want to Make Overseas Investing Just a Few Clicks Away," THE WALL STREET JOURNAL, Apr. 26, 1999, at R12 (describing actions of two German banks in establishing relationships with U.S. discount brokers, through which German investors are currently able to trade U.S. securities over the internet. Like Euroamerican, (and the Hong Kong broker in *Bear Stearns*), the German banks collect and forward to a U.S. broker the information necessary to open a new account at the U.S. broker for each foreign investor. For example, Schmidt Bank, one of these banks, currently makes the new account forms available on the web site of its broker subsidiary, Consors Discount Broker AG, *see* www.consors.de/. Using these forms, German investors can open accounts at "unserem amerikanishen Partner," Web. St. Securities, a U.S. broker-dealer in Illinois, and effect trades in these accounts over the internet.)

Euroamerican. And, in any event, there is no support for the SEC's startling contention that one rule of law should apply to a "substantial" New York-based securities firm doing business with a "substantial" foreign broker-dealer, while a different rule should apply to a regional securities firm in Minneapolis doing business with a Greek investment firm that is, in the SEC's opinion, less than "substantial." Certainly, neither Section 30(b) nor Rule 15a-6 makes this distinction. Thus, even if Euroamerican *had* been established exclusively to provide its Greek customers access to the U.S. securities markets by dealing with one or more registered U.S. broker-dealers, and did so, that business would still be a foreign "business in securities" and the transactions it effected would still be transactions in securities "with . . . a registered broker-dealer."

While it dismisses the Section 30(b) cases and other authorities cited in the Petition as "scant authority" (Opp. at 11), the SEC does not explain why it makes no reference in its Opposition to the *only* two cases it cited below (discussed at Pet. 24 and 27, n. 29) in support of its contention that Zahareas is an "associated person" of Tuschner & Co. In fact, these unreported district court cases provided no support for the position taken by the SEC regarding Zahareas. But the SEC provides no substitute for its now-jettisoned "authority," thus making it quite clear that **no** court or administrative interpretation has previously held that foreign broker-dealer personnel, who do nothing more than engage in routine securities purchases and sales with a U.S. broker-dealer, and whose activities do not involve any U.S. investor, may nevertheless be deemed "associated persons" of the U.S. broker.

It thus appears unmistakable that the reason the SEC has taken the position it has in this case has less to do with implementing a consistent scheme of regulation than with institutional chagrin that, after being barred from the U.S. securities industry, Zahareas nevertheless found employment in the securities industry of a foreign country. But Greek law

does not preclude Zahareas' activities in Greece. And, as the SEC correctly acknowledged when it enacted Rule 15a-6, it has no valid interest in protecting Greek or other foreign investors from the activities of foreign brokers,[15] and its interest in safeguarding the domestic securities markets is fully satisfied by requiring the interpositioning of a U.S. broker to enter the U.S. markets.[16]

CONCLUSION

For the foregoing reasons, the Petition for a writ of certiorari should be granted.

Respectfully submitted,

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[15] "[T]he primary responsibility for protecting foreign investors from wrongful conduct of foreign securities professionals properly lies with foreign securities regulators." SEC Release 34-25801, 1988 WL 239776, *9 (S.E.C.).

[16] "[T]he use of a U.S. broker-dealer to enter the U.S. securities markets provides protection to the U.S. markets." *Id.*.